

## Message Text

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ACTION EB-07

INFO OCT-01 AF-04 ARA-06 EUR-12 EA-06 NEA-06 ISO-00 FEA-01

AEC-05 AID-05 CEA-01 CIAE-00 CIEP-01 COME-00 DODE-00

FPC-01 H-01 INR-05 INT-05 L-02 NSAE-00 NSC-05 OMB-01

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TO SECSTATE WASHDC PRIORITY 9352

INFO AMEMBASSY ABU DHABI

AMEMBASSY ALGIERS

AMEMBASSY BEIRUT

AMEMBASSY CARACAS

AMCONSUL DHAHRAN

AMEMBASSY JAKARTA

AMEMBASSY JIDDA

AMEMBASSY KUWAIT

AMEMBASSY LAGOS

AMEMBASSY LONDON

AMEMBASSY QUITO

AMEMBASSY TRIPOLI

USMISSION OECD PARIS

USMISSION EC BRUSSELS

AMEMBASSY VIENNA

C O N F I D E N T I A L TEHRAN 10431

KUWAIT PASS KOHA

BEIRUT PASS BAGHDAD

E.O. 11652: GDS

TAGS: ENGR, IR

SUBJ: OIL PRICES: HOW CONSUMERS AND PRODUCERS MIGHT DISCUSS THEM

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1. SUMMARY: IN THE ABSENCE OF A PRODUCER-CONSUMER MEETING, OIL

CONSUMING NATIONS FACE THE PROSPECT OF FURTHER UNILATERAL PRICE INCREASES BY OPEC WITH LITTLE CHANCE THAT THE TREND WILL BE REVERSED IN THE NEXT FEW YEARS. AT BEST WE WILL FACE ON JANUARY 1 A SINGLE PRICE SYSTEM AT A LEVEL SOMEWHAT HIGHER THAN THAT OF OCTOBER 1 AND POSSIBLY LINKED TO AN OPE-DETERMINED INDEXING MECHANISM. WE BELIEVE THERE IS NOTHING TO LOSE AND PERHAPS SOMETHING TO BE GAINED BY A CONSUMER-PRODUCER DIALOGUE IN WHICH CONSUMERS' NEGOTIATING TACTIC WOULD BE TO ACCEPT THE PRINCIPLE OF LINKING OIL PRICES TO A MARKET BASKET OF OTHER COMMODITIES AND TO ATTEMPT TO DEVISE AN INDEX MECHANISM FAVORABLE, TO THE MAXIMUM EXTENT POSSIBLE, TO CONSUMERS. WE MIGHT AIM FOR AN INDEXING AGREEMENT OF TWO TO THREE YEARS DURATION. END SUMMARY.

2. IT SEEMS TO US THAT IF WE DO NOT SIT DOWN SOON WITH OIL PRODUCERS WE WILL FACE AN UNFAVORABLE AND PERHAPS STEADILY WORSENING OIL PRICE PICTURE. UNTIL RECENTLY, IT APPEARED WE WOULD FACE A "SINGLE PRICE" SYSTEM BASED ON THE OCTOBER 1 WEIGHTED AVERAGE GOVERNMENT TAKE ON ARABIAN LIGHT AND LINKED TO AN INFLATION/DEFLATION INDEX. NOW THE OPEC ECONOMIC COMMISSION HAS RECOMMENDED TO OPEC MINISTERS A SINGLE PRICE SYSTEM BASED ON A STILL HIGHER LEVEL OF GOVERNMENT TAKE (PLUS PRODUCTION COST PLUS "COMPANY MARGIN"). THE REASON FOR THIS HIGHER LEVE, IT APPEARS, IS THAT THE SHAH AND OTHER FEEL YAMANI'S FORMULA, ANNOUNCED AT ABU DHABI, HAS SET A "NEW, HIGHER FLOOR" FOR WEIGHTED AVERAGE GOVERNMENT TAKE. (COLUMNIST JOSEPH KRAFT HAD TOLD US THAT THE SHAH, IN A NOVEMBER 24 AUDIENCE, USED EXACTLY THOSE WORDS IN REFERRING TO THE YAMANI FORMULA.) EVEN IF THE SAG SELLS GOVERNMENT CRUDE AT LOWER PRICES, OR SETS LOWER PRICE FOR SALE TO ARAMCO PARTNERS UNDER A "100 PERCENT PARTICIPATION" ARRANGEMENT, WE SERIOUSLY DOUBT WHETHER OPEC WILL ACCEPT ANY PRICING ARRANGEMENTS AT A LEVEL LOWER THAN IRAN'S ORIGINAL SINGLE-PRICE PROPOSAL (WHICH AMOUNTS TO AN AVERAGE COST SLIGHTLY HIGHER THAN THE OCT 1 LEVEL). FURTHER, THE OVERWHELMING BODY OF OPINION IN OPEC APPEARS TO SUPPORT "INDEXING" THE PRICE OF OIL TO THAT OF A MARKET BASKET OF OTHER COMMODITIES. WE FULLY EXPECT OPEC TO ADOPT SUCH AN INDEXING PROCEDURE EARLY NEXT YEAR, AND TO APPLY IT UNILATERALLY UNLESS CONSUMERS EXPRESS A DESIRE TO NEGOTIATE IT BEFORE HAND. IN SHORT, THERE ARE GOOD GROUNDS TO BELIEVE THAT UNLESS CONSUMERS NEGOTIATE WITH PRODUCERS, THE PRODUCERS WILL PROBABLY CONTINUE TO MAKE UNILATERAL DECISIONS, DETRIMENTAL TO CONSUMERS' INTERESTS.

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3. THUS WE FEEL THAT VERY SERIOUS CONSIDERATION SHOULD BE GIVEN TO THE IDEA OF A CONSUMER/PRODUCER MEETING AT AN EARLY DATE. WE BELIEVE THAT TOPICS OF PRICES AND RECYCLING (THE TWO MAIN AGENDA ITEMS FOR SUCH A MEETING) CAN BE APPROACHED IN SUCH A WAY THAT IT WOULD BE POSSIBLE (A) QUICKLY TO DEVISE A UNITED CONSUMER POSITION AND (B) TO MOVE FROM THE ARENA OF CONFRONTATION TO NEGOTIATION AND COOPERATION. RECYCLING PLANS SEEM TO BE ADVANCING RAPIDLY

DUE TO THE SECRETARY'S RECENT PROPOSAL. WE SHOULD LIKE SIMPLY TO NOTE THAT RECYCLING MAY WORK BETTER IF ARRANGEMENTS ARE SUPPORTED BY OPEC GOVERNMENTS. OUR PURPOSE IS TO SUGGEST HOW PRICES MIGHT BE DISCUSSED.

4. WE FEEL THAT OUR MOST PROMISING COURSE WOULD BE TO ACCEPT THE PRINCIPLE OF PRICE INDEXATION AND TO ATTEMPT TO TMAKE IT WORK FOR US. THIS COURSE OFFERS SEVERAL ADVANTAGES: (A) A REASONABLE CHANCE OF CONSUMER NATIONS' BEING ABLE TO FORGE A UNITED POSITION AT THE EXPERT LEVEL (SEE PARA 5 BELOW); (B) A POSSIBILITY OF REMOVING "CONFRONTATION PSYCHOLOGY" FROM A MEETING WITH OPEC, BECAUSE THIS APPROACH MEETS OEC'S DEMAND THAT "OTHER COMMODITEIS" BE DISCUSSED AS WELL AS OIL; (C) IT MAY BE POSSIBLE TO CONSTRUCT AN INDEX THAT COULD BRING ABOUT SOME REAL DECREASE IN THE PRICE OF OIL.

5. IF IEA AND FRENCH EXPERTS WERE ASSIGNED THE TASK OF DESIGNING CONSUMER NEGOTIATING POSITIONS ON INDEXING, THEY WOULD HAVE THREE VARIABLES TO CONSIDER: (A) THEY COULD SUGGEST APPROPRIATE "BASE RELATIONSHIPS" BETWEEN THE PRICE OF OIL AND THE PRICES OF OTHER COMMODITIES. IF WE WERE TO COMPARE THE SHAH'S THEORETICAL "\$7 OIL" ON JANUARY 1, 1974, TO JANUARY 1 PRICES OF OTHER COMMODITIES, FOR EXAMPLE, THIS WOULD SURELY BE A MORE FAVORABLE RELATION (FOR CONSUMERS) THAN THE ONE EXISTING TODAY. (B) THEY COULD ATTEMPT TO DESIGN MARKET BASKETS HEAVILY WEIGHTED WITH COMMODITIES WHOSE PRICES TEND TO FALL MOST SHARPLY WITH A SLOWDOWN IN ECONOMIC ACTIVITY, THAT IS, MARKET BASKETS THAT ARE MORE LIKELY TO FALL THAN TO RISE. (C) THEY COULD DEVISE FORMULAS TO RELATE THE PRICE OF OIL TO THE PRICE OF THE MARKET BASKET: CONSTANT FACTORS COULD BE INTRODUCED INTO SUCH FORMULAS THAT WOULD PROVIDE FOR OIL PRICES TO RISE MORE SLOWLY THAN OTHER GOODS IN A RISING MARKET COMPOSED OF MORE THAN ONE FORMULA--EACH ON APPLICABLE IN A DEFINED ECONOMIC SITUATION. THE GOAL OF THIS EXERCISE WOULD

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BE TO DEFINE A PRICE RELATIONSHIP (OIL TO OTHER GOODS) MORE FAVORABLE THAN THE PRESENT ONE, TO ATTEMPT TO CONVINCE OPEC OF ITS SUITABILITY, AND TO DEFINE MARKET BASKETS AND FORMULAS THAT COULD MOVE US TOWARD THAT MORE FAVORABLE RELATIONSHIP.

6. WE BELIEVE THAT EXPERTS COULD DESIGN A SERIES OF TECHNICAL POSITIONS (FROM MAXIMUM DESIRED TO LAST FALLBACK) ON WHICH CONSUMERS MIGHT BE ABLE TO AGREE AND WHICH CONSUMERS WOULD STAND SOME CHANCE OF NEGOTIATING WITH OPEC. IF WE WERE TO AIM AT A TWO TO THREE YEAR AGREEMENT WITH OPEC, WE COULD SURELY DO NO WORSE THAN WE ARE LIKELY TO DO BY INACTION IN THAT PERIOD. EVEN IF CONSUMERS AND OPEC, IN THE END, AGREE TO DISAGREE, WE MIGHT SUCCEED IN INFLUENCING OPEC PERCEPTIONS OF HISTORICAL ECONOMIC FACTS THROUGH PRESENTATION OF CONSUMERS' ANALYSIS AND DATA IN SUPPORT OF OUR POSITION.

7. THE SHAH HAS SUGGESTED ON A NUMBER OF OCCASIONS THAT CONSUMERS HAVE WASTED A LOT OF TIME TALKING ABOUT TALKING TO THE PRODUCERS. WE WOULD HOPE HIS APPARENT WILLINGNESS TO NEGOTIATE THE ISSUE OF INDEXATION (SEPTTEL) DOES NOT TURN OUT TO BE A MISSED OPPORTUNITY.  
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## Message Attributes

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